

DEPARTMENT OF STATE REVENUE

**LETTER OF FINDINGS NUMBER: 96-0649
SALES AND USE TAX**

FOR TAX PERIODS: 1994-1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

Issues

1. Sales and Use Tax- Electronic Pre-Press Equipment

Authority: IC 6-2.5-3-2(a), P.L. 78-1989, IC 6-2.1-2-4, IC 6-2.5-5-3, Gross Income Tax Division v. National Bank and Trust Co., 79 N.E. 2nd 651, (Ind. 1948), Indiana Department of State Revenue v. Cave Stone, Inc., 457 N.E. 2nd 52 (Ind. 1983).

Taxpayer protests the assessment of tax on the electronic pre-press equipment.

2. Tax Administration-Penalty

Authority: IC 6-8.1-10-2.1 (a).

Taxpayer protests the assessment of penalty.

Statement of Facts

Taxpayer, a commercial printer, produces items such as brochures, catalogs, and file folders. Additional sales and use tax was assessed after a routine audit. Taxpayer timely protested a portion of the assessment and a hearing was held. More facts will be provided as necessary.

1. Sales and Use Tax- Electronic Pre-Press Equipment

Discussion

Taxpayer's clients provide Taxpayer with digital files. These files contain the completed art and design work which is processed in the pre-press area so Taxpayer can print the final products. Taxpayer protests the assessment of tax on computers and software which were used exclusively in this pre-press area.

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. A number of exemptions are available from use tax including those collectively referred to as the manufacturing exemptions. All exemptions must be strictly construed against the party claiming the exemption. Gross Income Tax Division v. National Bank and Trust Co., 79 N.E. 2nd 651, (Ind. 1948). IC 6-2.5-5-3 provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used in the direct production, manufacture, fabrication of tangible personal property."

Taxpayer contends that the computers and software which it purchased in 1994 and 1997 qualify for this exemption which requires that qualifying property be directly used in the direct production process. Exemption is only granted to machinery that is used in a production process, the process of manufacturing tangible personal property. Therefore the first issue to be determined is whether the commercial printing process is a process which produces tangible personal property. The 1989 General Assembly enacted a series of amendments in P.L. 78-1989 which dealt with the characterization of commercial printing.

P.L. 78-1989 first amended IC 6-2.1-2-4 to read as follows:

The receipt of gross income from the following is subject to the rate of tax prescribed in Section 3 (a) of this chapter:

...

(7) The business of commercial printing that results in printed materials, excluding the business of photocopying.

From this initial provision in the gross income tax, amendments were then made to other gross income tax, adjusted gross income tax and sales/use tax provisions, cross referencing back to commercial printing as described in IC 6-2.1-2-4. Significantly, P.L. 78-1989 amended IC 6-2.5-5-3 adding the language underscored below that expressly references and incorporates the description of "commercial printing" set forth in IC 6-2.1-2-4.

(a) For purposes of this section:

...

(2) Commercial printing as described in IC 6-2.1-2-4 shall be treated as the production and manufacture of tangible property.

Since the above cited statute defines commercial printing as a manufacturing process, the computers and software will qualify for exemption if they are directly used in this direct production process. In Indiana Department of State Revenue v. Cave Stone, Inc., 457 N.E. 2nd 52 (Ind. 1983) the Court sets forth the test for determining whether a particular item qualifies for the directly used in direct production exemption from use tax. The Court stated that items which are considered essential and integral to the production process meet the requirements of the directly used in direct production language of the statute.

The computers and software in this situation are essential and integral to the production of Taxpayer's brochures, catalogs, programs, and other items. Therefore they qualify for the directly used in direct production exemption. (Also, see Sales Tax Information Bulletin #69, 1999)

Finding

Taxpayer's first point of protest is sustained.

2. Tax Administration- Penalty

Discussion

Taxpayer's final point of protest concerns the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1 (a). This statute is clarified by regulation at 45 IAC 15-11-2 (b) which states as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The audit assessed use tax on such clearly taxable items as office furniture and supplies. Taxpayer has a duty to read the law and publications of the Indiana

Department of Revenue and pay the correct amount of tax. During the tax period, Taxpayer did not have a system to self-assess use tax when no sales tax was paid. Taxpayer's breach of this duty constitutes negligence.

Finding

Taxpayer's protest is denied.

KA/PE/MR/00/23/6